

Narendrakumar Nakhat Vs. M/S. Nandi Hasbi Textile Mills Ltd. and Others

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Court : Karnataka

Decided On : Oct-08-1996

Reported in : ILR1997KAR1; 1997(1)KarLJ755

Judge : R.P. Sethi, C.J. and ;S. Rajendra Babu, J.

Acts : [Indian Contract Act, 1872](#) - Sections 74

Appeal No. : Company Appln. No. 542 of 1996 in Company Pten No. 25 of 1985

Appellant : Narendrakumar Nakhat

Respondent : M/S. Nandi Hasbi Textile Mills Ltd. and Others

Advocate for Def. : S.M. Chandrashekar, ;N.B. Bhat, ;S. Krishnaiah and ;M/s. Tukaram S. Pai, Advs.

Advocate for Pet/Ap. : Udaya Holla for Basava Prabhu Patil, Adv.

Judgement :

ORDER

Rajendra Babu, J.

1. This Company Application is filed in Company Petition No.25 of 1985 which had, been, filed for winding up M/s. Nandi Hasbi Textile Mills Ltd., which is now under liquidation. This Court by an order made on 26-10-1994 passed in O.S.A.

No. 17/1993 directed the official Liquidator to advertise for sale of the mill of the said company comprising of 25 spindles, about 13 acres of free hold land and buildings with a layout of 1,010,000.Sq. ft. and plant and machinery on 'as is where is basis': The sale of the said assets were offered subject to certain terms and conditions. The most important of them being conditions 3,5,6 and 7 which are extracted below:

'XX XX 3. That the offer should be accompanied with a bank draft of Rs. 5,00,000 drawn in favour of the Official Liquidator Karnataka Bangalore, payable at:

Bangalore, as earnest money deposit. The HMD will be adjusted towards the bid amount in case of successful bidder

4. xx xx 5. That the successful bidder shall have to deposit 25% of the bid money within 7 days from the date of acceptance of the bid by the official liquidator and the balance 75% within 30 days from the date of confirmation of sale by the Hon'ble High Court of Karnataka.

6. That the tender money (EMD of Rs. 5,00,000) shall not carry any interest and Shall be liable for forfeiture in case of default by the successful bidder. The earnest money of unsuccessful bidder shall be refunded forthwith after conclusion of tender proceedings.

7. That the sale is subject to confirmation of the Hon'ble High Court of Karnataka Offers containing any subjective clause, in-complete offer shall be liable for rejection.'

2. The said offer was advertised in the newspapers and the applicant offered his bid at Rs. 2,36,00,000/-. The said bid was accepted. Before making the offer, the applicant had deposited a sum of Rs. 5,00,000/- by way of Earnest Money with the Official Liquidator and on becoming successful bidder, he deposited a further sum of Rs. 59,00,000/- on 26-2-1995 in terms of condition No. 5 being 25% of the bid amount. However, this Court in O.S.A. No. 17 of 1993 by order dated 26-2-1996, cancelled the acceptance of the said bid made on 18-1-1995 under certain circumstances and this Court directed the Official Liquidator to issue fresh

advertisement inviting tenders for sale of the properties under the directions of the Company Judge, with a floor price of Rs. 2,40,00,000/- (Rupees Two Crores Forty Lakhs).

3. Now, this application is filed by the highest bidder seeking for refund of the amount in a sum of Rs. 64,00,000/- deposited by the applicant with the Official Liquidator alongwith interest that had accrued thereto and to grant such other reliefs as are just in the interest of justice and equity.

4. This application is opposed by the Secured Creditors on the ground that the applicant is guilty of breach of contract and therefore is not entitled to the refund of the amount deposited by him and an enquiry should be held to fix the quantum of compensation payable by the applicant to the General Body of creditors and until such time the amount in deposit should not be ordered to be refunded.

5. The learned Company Judge on 12-4-1996 made an order to the following effect :--

'Keeping in view the objection raised by the Official Liquidator, let the secured creditors be added as party-respondents and notice be issued in relation to the prayer made.

In the meantime, Official Liquidator to refund Rs. 50 lakhs out of sum of Rs. 5 lakhs and Rs. 59 lakhs which had been deposited as amount of security plus 25% bid amount. The rest of the amounts are not being refunded since those may be liable to forfeiture clause to meet the cost which has been met by the Official Liquidator in relation to the transaction in question.

6. Under the terms of the sale offered by this Court a sum of Rs. 5,000,000/- had been deposited by the applicant alongwith his offer by way of Earnest Money. The characteristic of Earnest Money has been explained tersely but succinctly in *Kunwar Chiranjit v. Har Swamp*, AIR 1926. PC. 1 and in the words of Lord Shaw -- 'Earnest Money is part of the purchase price when the transaction goes forward: it is forfeited when the transaction falls through, by reason of the fault or failure of the vendee.' This definition of the 'Earnest Money' has been approved and adopted

by the Supreme Court in *Mulla Bux v. Union of India*, AIR 1970 SC 1995. In *Shree Hanuman Cotton Mills v. Tata Aircraft Ltd.* : [1970]3SCR127 the Supreme Court has reiterated the legal position thus: 'Earnest must be given at the moment at which the contract concluded. It represent a guarantee that the contract will be fulfilled, in other words, earnest is given to bind the contract. It is part of the purchase price when transaction is carried out. It is forfeited when the transaction falls through by reason of default or failure of purchaser; and unless, there is anything to the contrary in terms of the contract, or default committed by the buyer, the seller is entitled to forfeited the earnest. 'Thus the characteristic of Earnest money is that it serves two purposes-firstly, it goes in part payment of the purchase money for which it is deposited and, secondly, but primarily, it is security for the performance of the contract.

7. According to the terms of the offer made in the present case, the sale is subject to confirmation of this Court and the tender money i.e., Earnest money deposit of Rs. 5,00,000/- would be liable for forfeiture in the case of default by the successful bidder. The earnest money of unsuccessful bidders shall be refunded forthwith after the conclusion of the tender proceedings. In this case, there is no confirmation of sale in view of the order made by this Court in O.S.A. No. 17/-1993, disposed of on 26-2-1996 and the bid accepted in favour of the applicant on 18-1-1995 stood cancelled. Thus the offer made by the applicant itself has not been accepted by this Court. The tender proceedings in the present case came to be concluded by the order of this Court in O.S.A. No. 17/1993 on 26-2-1996. Unless the sale is confirmed in terms of Clause (7) of the terms and conditions of sale, the sale would not become absolute. As long as the transaction is inchoate or incomplete for any reason and the acceptance of the bid is cancelled, the parties are relegated to the original position even though the cancellation of the acceptance of the bid may be on account of the conduct of the bidder himself. By virtue of the cancellation of the acceptance of the bid, the offer made by the bidder is not accepted. It is only on acceptance of the offer made by the bidder, other clauses would stand attracted. This is a case where the sale proceedings were cancelled on account of the conduct of the parties in not doing one or the other acts provided under the terms of sale. The act attributed to the applicant is that he had adopted the stance of filibuster by indulging in dilatory tactics in postponing the proceedings for

confirmation of sale. If the Court had confirmed the sale, other terms and conditions in the offer of sale would have arisen. In the absence of such an event of confirmation of sale, the only conclusion we have to draw is that the applicant is prima facie entitled to the entire refund of the money. But the learned Company Judge restricted the payment to only Rs.50,00,000/-. The question whether the amounts due by the applicant by reason of non-performance of his part of the contract in any manner arises and whether any damages payable by him, could be appropriately adjudicated at a later stage.

8. Clause 6 of the conditions for sale provides for forfeiture of the sum of Rs. 5 lakhs in the event of default by the successful bidder. Section 74 of the Contract Act provides for measure of damages in two classes of cases-- (i) where the contract names a sum to be paid in case of breach; (h) where contract contains any other stipulation by way of penalty. In the latter case, the measure of damages is by Section 74 of the Contract Act-- reasonable compensation not exceeding the penalty stipulated for. In *Fateh Chand v. Balkishen Das*, : [1964]1SCR515 it was observed that Section 74 of Contract Act boldly cut across the web of rules under English Common law by enacting uniform principle applicable to all stipulations naming amounts to be paid in case of breach and stipulations by way of penalty. The Supreme Court explained the scope of Section 74 of the Contract Act in *Sir Chunilal V. Mehta & Sons Ltd. v. Century Spinning and .*, : AIR 1962 SC1314 and stated that the sum to be paid in repudiated contracts and stipulation for payment of the same by way of liquidated damages would exclude the right to claim unascertained sum of money as damages. The right to claim liquidated damages is enforceable under Section 74 of the Contract Act and when such a right is found to exist, no question of ascertaining damages really arises. Where the parties have deliberately, specified the amount of liquidated damages, there can be no presumption that they at the same time, intended to allow the party who has suffered by the breach to give a go-by to the sum specified and claim instead a sum of money which was not ascertained or ascertainable at the date of the breach. It has been noticed in *Maula Bux's case* : [1970]1SCR928 that forfeiture of earnest under a contract of sale of property -- if the amount reasonable does not fall within scope of Section 74 for forfeiture of a reasonable amount paid as earnest money which does not amount to imposing penalty. But if forfeiture is of

nature of penalty, Section 74 applies. Thus where-under the terms of contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which has already been paid to the party complaining of breach of contract, the undertaking is of the nature of penalty. The Earnest Money Deposit in this case must be treated as by way of liquidated damages and in Clause (6), this position is made clear that such amount will be liable for forfeiture on account of any default by him. Therefore, by no stretch of imagination can we say that the respondents can insist upon retention of money in excess of the sum ordered by the learned Company Judge.

9. The learned Company Judge made an order on 12-4-1996 and that order has not been challenged in an appeal. Therefore, the applicant cannot now seek for refund of the entire amount, but only to the extent indicated by the learned Company Judge. The said sum of Rs. 50,00,000/- and the interest accrued thereon shall be refunded to him. The order of the learned Company Judge is made absolute by this Order. Company Application shall stand disposed of accordingly.

10. Order accordingly.